From Cost to Performance Management

A Blueprint for Organizational Development

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John Wiley & Sons, Inc.

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This book is dedicated to Robin Cooper and
H. Thomas Johnson: the ones who lead the way.

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Preface

Progress or Poison: Developmental Disciplines for Cost and Performance Management

What is food to one man may be fierce poison to others.

—Lucretius—De Rerum Natura. iv. 637.[1]

Why do organizations continue to struggle with cost management? Why do so many performance management projects fail to deliver the promised results over the longer term? After all, cost and performance are the very blood and bone of an organization, as ancient as commerce itself. We should know by now how to orchestrate and manage them. There certainly is no lack of technical solutions, from enterprise-wide software systems, to balanced scorecards, to strategic cost management and target costing. The workforce is more highly educated than any other time in history. Competent employees show up at work day after day. For the most part, well-intentioned executives do too. Still, success in managing cost and performance is elusive to the point that true successes almost seem random, and unrepeatable due to a unique set of ideal causes and conditions.

In an era of computer hubris and the proliferation of other technical communication devices, it is maddening that the same core issues remain for many organizations:

- Uncertain financial performance
- Unpredictable costs and expenses
- Doubtful success of expensive change initiatives
- Questionable sustainability of implemented changes

Add to these the outright despair among executives faced with unprecedented failures in the ethics and structure of business and capital institutions. Mix in a healthy dose of employees who are burned out and who feel betrayed by financially driven restructurings, mergers, and acquisitions, not to mention occasional outright criminal executives. Such weary workforces often remain apathetic, if not bitter, in the face of any manager who dares bring forth another slogan of the week or silver-bullet project of the quarter. Why is it so difficult to make progress? What is missing?

There are those who offer to solve these dilemmas. As scholars continue to pump out new theories of cost and performance in the publish-or-perish world of

academia, enterprising consultants quickly grab hold and market the best and brightest of these ideas for a management world struggling with endemic uncertainty and change. The consultants, if not always the academics, get richer, but problems, at best, are frequently solved only partially or provisionally. Executives and managers, working to improve cost and performance in their organizations, generally adopt these management methodologies with the philosophical and brand loyalty and rivalry of Ford/Chevy pickup truck customers.

The purpose of *From Cost to Performance* is to index the specific advantages and shortcomings of the most widely used cost and performance management methodologies practiced today. Using this relatively familiar foundation, a tested and proven scientific viewpoint layers on a lifelong learning and developmental perspective. But first, some additional context . . .

PROGRESS OR POISON?

Virtually every product and service in the western market is evolving to address consumer desires with greater and greater degrees of specialization and customization. Why then, do the so-called cost and performance experts typically adhere rigidly to the constraints of a single cost or performance management paradigm, even when these limited means frequently fail to meet the organization's needs or support the sustainable changes that an organization requires?

One of the root causes of such perennial difficulties lies at the source of the expertise and the market conditions imposed on management specialists. Whether a scholar, a consultant, an entrepreneur, or some combination develops a new management methodology, the idea is typically publicized and/or introduced in a competitive marketplace, and the idea has to beat the competition. Competing against one another, management specialists work to influence organizational executives to adopt their new ideas and methods for improving perceived cost and performance shortcomings without including the cost and performance managers that implement and apply them. Generally, the management specialists do so by marketing their ideas as comprehensive solutions—a logical outcome in the context of intense management methodology market competition.

A second part of the cause of frequent change initiative failure can be found in the knowledge base of the management specialists advocating their new systems. They often demonstrate a lack of competence outside a single discipline, usually finance and accounting, information technology, or manufacturing operations. Those who claim multidisciplinary management expertise may lack experience with strategy and organizational behavior. It is the rare advisor who has scientific training; rarer still is the trainer who has rigorously studied human behavior. This competitive consulting market does not establish competency criteria for the people peddling wares purported to accomplish one of the world's most complex activities—guiding organizations to continuous improvement.

Clearly, as currently practiced neither business nor economics are hard sciences. Economics is largely a game of mathematical models that, as the old saying goes, never reach a conclusion when laid end to end. Current business practices are, for the most part, a blend of mechanical/technical expertise and financially driven behavior patterns, with an occasional nod to those troublesome human beings called employees.

A third piece to the puzzle of change management failure is so embedded in business practice that it is in essence invisible. Consider these terms: *industrial revolution, financial capital, scientific management, information age, process improvement, strategic objectives.* Compare these with the terms *trust, leadership, meaning and purpose, constituents, culture, integrity, community awareness.* Just for a moment, get the comparative *feel* of the two lists. Notice the difference. If you are open to this moment, you may experience something like the following when reading the first set of terms: hard, tangible, business-like, no-nonsense, actionable, martial. As a member of today's management value system, you may react to the second list with disdain. We hope that this book will change the way you see this second list in terms of the ways it can be applied to initiate sustainable positive change for your organization.

As a unit, these three root causes of change management failure spring naturally from sincere human endeavor: desire to improve, focus of specialization, and efforts to make things work. Each is valuable under certain conditions and times. However, these three are no longer sufficient on their own to create successful enterprises that are also humane places to earn a livelihood. These three simply do not provide a comprehensive viewpoint. Recently, each of these three conditions has been challenged by explorative paradigms. Market competition has yielded ground to practices such as strategic alliances (often with competitors) and interorganizational cost management. Business experts have begun exploring the physical and life sciences in search of improved models for managing organizations. Mechanical and martial cultures find themselves confronted with upstart organization structures that are more humane, autonomous, and adaptable.

PARTIAL PROGRESS

The new frontier buzzwords appear more and more regularly, like groping hands searching for the lantern that will reveal the mystery of management. Terms include the likes of *complex adaptive systems, chaos theory, enterprise agility, culture transformation, relationship management,* and, of course, the now ubiquitous *customer intimacy.* These healthy explorations push the edges of our communal understanding of the organization and how it works. All yield new insights. However, to date, the fragmented expeditions into these territories have delivered mixed results—as would be expected from any greenfield effort. How many product/service launches actually become successful? As organization managers probe

these cross-disciplinary channels for ways to improve their lifeblood of cost (i.e., valuable resources), and to strengthen the bones of their performance activities, commonalities begin to emerge. Six insights capture the progress made in the development of our collective wisdom so far:

1. Organizations are only partially composed of technical/mechanical and financial capital; the remaining components reside in human capital.
2. Command-and-control models are inappropriate, and even harmful, for many organizations, especially with autonomous, educated workforces, and advances in telecommunications.
3. Financial results remain important; however, they must be viewed as results of prior processes and activities carried out by motivated, skillful people.
4. Change is not a periodic disturbance; rather, change is a natural and healthy condition of anything composed of matter, especially if it is alive and sentient.
5. Being able to learn and adapt is more valuable and productive than putting effort toward maintaining outmoded structures and activities.
6. Ethical and moral boundaries are breached when financial/technical concerns are primary, and the human community is forgotten. In other words, to keep the financial/growth-only model running, executives will inevitably have to sell their souls.

Two common threads seem to be emerging:

1. The living and human dimensions must be integrated with technical/mechanical expertise for a complete organization perspective.
2. Learning leads to intelligent action and behaviors that, in turn, fuel individual and organizational success.

This is not an either–or choice between financial/technical and some ill-defined soft-side elements. As with most solutions to complex problems, the organizational dilemma requires an *and* solution. Integrating the working components of the *human and learning* dimensions with *cost and performance* practices creates synergistic advantages in the marketplace, and well being within the organization. We all know this, but we remain confused about the details of how to adapt and change. We all want more happiness in our organizations, and less suffering, yet we are frustrated and sense some essential, missing insight that would help us take the next steps.

THE MISSING PERSPECTIVE: DEVELOPMENT

If any currently practiced management methodology were truly comprehensive, it would work for everyone, every time. Even Microsoft applications don't do that. If such a panacea existed, we would all know about it, and its inventor would

dwarf the fame and fortune of Bill Gates. Since no such methodology does or ever will exist, the intention of this book is not to provide a one-meal, single-answer fish, but rather to instruct on the art of fishing. It carries no guarantees of catching anything, but it describes the whereabouts of some secret fishing holes, and vastly improves the chances of a satisfying supper at the end of the day.

Again, the purpose of *From Cost to Performance* is to index the specific advantages and shortcomings of the most widely used cost and performance management methodologies practiced today within the context of how organizations develop. It is time to entirely stop using either–or viewpoints with cost and performance—the old and tired "either we contain costs *or* we improve performance." Using familiar cost and performance foundations, a tested and proven scientific viewpoint—development—layers on a lifelong learning management perspective. In other words, a benefit/shortcoming index requires an appropriate context, and this book uses organizational development as a natural choice since organizations are made up of living (always), developing (usually) human beings. This expanded perspective encourages starting with valuable resources, typically defined as costs, and using them to create excellent performance—thus, *from* cost *to* performance.

This unusual developmental perspective provides the essential missing information to increase survival and success odds for *any* cost and performance initiative, regardless of brand or relative popularity. Not for a moment are the financial and technical factors forgotten. Throwing these out would discard centuries of human progress. And no, there is no claim to have the one, comprehensive, works-every-time solution. Rather, this book-length exploration presents a management navigational chart to aim for organizational maturity milestones (a journey, not a destination) and to track progress, regardless of planned objectives or technical method choices.

Why development? First, human development is a rich science. Much of the research and knowledge accumulated in this discipline can be directly transferred from the individual to the organization. Development is the most orderly, common, and reproducibly reliable way to look at meaningful human change over time. Within that context, the chapters that follow address how organizations mature by indexing the ways they understand and use cost and performance management methods.

Chapter 1 examines the shortcomings of existing change and growth management perspectives and introduces the fundamental principles of individual and organizational development that will serve as a reference for indexing the maturity of cost and performance management methods and systems in later chapters.

Chapter 2 addresses the developmental dynamics of the relationship between cost and financial accounting systems in terms of the profit imperative and how they shape an organization's cost management system. In the process, the chapter indexes the value-focused design features people can use when evaluating the maturity of current cost management systems (CMSs). In transferring these value-focused design features into an existing CMS, people make the commitment to see cost in new ways.

Chapter 3 examines the traditional language of cost accounting in terms of its developmental shortcomings. As an organization learns and develops more mature ways to see its work, it must understand the limitations of the traditional cost terminology before new insights can be applied to cost management. This chapter specifies the ways that cost is a fundamental measure of performance. The broader and more precise the cost information base, the better the decisions made from it.

Chapter 4 utilizes the developmental insights into cost language from Chapter 3 to characterize the developmental shortcomings of the methods used by conventional cost accounting systems to manage cost—standards, budgets, and forecasts. Chapter 4 investigates these conventional practices in terms of more mature ways of seeing and managing costs and the commitment to discover the relationship between process and profits. As organizations see costs in new ways, they develop new methods of managing costs.

Chapter 5 creates a bridge between the conventional perspectives on cost and performance management and the steadily more mature systems that organizations develop through their life cycles. As a developmental starting point, the financial-cost perspective viewpoint characterized in the first four chapters gives way to more mature ways of seeing decision support by providing broader information perspectives. The necessary insight at this stage of development is operational information because the operations-process dimension increases the depth of management insight, thereby promoting decisions based on more complete information. Increased insight and information generate more options and choices that enhance the decision-making process. As described in this chapter, people learn to see traditional financial information as too late and too limited for day-to-day value creation, and they begin to learn to track value from the resources that create it.

Chapter 6 examines how some popular management techniques relate to the new, operational resource way of seeing cost and performance. Total Quality Management, Theory of Constraints, activity-based costing and Management, and resource consumption accounting are each indexed for their developmental maturity to give a better indication of when and how they should be applied to support organizational development.

Chapter 7 anticipates the formal use of strategy as the next phase of organizational development by indexing the developmental characteristics of seven management tactics: reengineering, value engineering, target costing, life cycle cost management, lean and agile management, supply chain costing, and interorganizational cost management. This chapter compares each management tactic against a strategic attribute array that details the way strategic advantage has developed in recent years.

Chapter 8 introduces the ways that formal intentional strategic management represents the next significant step in organizational development. Chapter 8 indexes the developmental advantages of three different coordinating systems designed to integrate organizational cost and performance management strategies:

strategic cost management, value-based management, and performance management. Specifically, the chapter explores value-based management in terms of economic value added, and compares four different methods of performance management in terms of the developmental advantages of each, including the Balanced Scorecard. At this stage, organizations learn that it is possible to continuously coordinate all profit-producing activities.

Chapter 9 looks toward the future of organizational development as it is expressed in the practices of the world's most mature organizations. Enticing as this may be, readers are urged to move through the book in an ordinal fashion, from the lowest page number to the highest because development occurs in a specific direction. At some point, everyone will encounter a paradigm in these pages that disturbs them because it seems either out of reach or preposterous. This is the way that you can discover the stage of maturity of your own organization and your own management thinking. All the paradigms in this book have been successfully and profitably mastered by someone, somewhere, and in some organization. We believe that if you and your coworkers address the immediate developmental needs of your own organization step by step, you will master them too. We invite you to begin.

JOE AND CATHERINE STENZEL

Minneapolis, Minnesota
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Chapter 1

Developmental Discipline in Cost and Performance Management

How in the world did human resources (HR) so quickly become a strategic priority in the world's most competitive, successful organizations? Behind all the management focuses—cost, performance, operations, strategy—resides the actual engine of organizational life and work: its people. Unfortunately, from the beginning to the end of our professional education, universities and consultancies have taught the world to believe that cost, performance, operations, and strategy somehow exist as manageable components apart from people. For example, accounting textbooks carefully describe how *costs* behave rather than focus on how *people* behave when spending organizational resources. Performance gurus suggest ways to devise strategy, characterize objectives, align business units, and develop and cascade measures, but the human dynamics behind these activities remains relatively unacknowledged and elusive. Operations experts teach a variety of remarkably efficient processes for work relationships within the organization and with its suppliers, but only tacitly address the human interface of the individual employee. Last but not least, strategy mavens show executives how to briskly and nimbly move their organizations through the landscapes of competitive change, but they seem to forget that "the organization" is a collection of people.

At virtually all levels, the world of business uses a static, component-based language to mechanically represent the organization and its activities. While *business units, divisions, departments,* and *functions* are useful component terms that give complex organizations a conceptual, manageable structure, most management teams speak as if they believe that these conceptual components actually do the work of the organization rather than the individual employees. The leaders of a few organizations have come to realize that human resources represent their most valuable competitive edge. Even so, these same relatively mature leaders struggle to leverage their people assets because management science has given them an inadequate vocabulary to manage the ways people learn and develop in an organizational context. Lacking an appropriate human management vocabulary, it seems easier to manage business units, divisions, and other conceptual components of the organization rather than people, giving rise to an inherent disconnect between leadership and the workforce.

The purpose of this first chapter is to carefully characterize cost and performance management in the context of managing the development of the people within the organization. As organizations develop and come to require more mature ways to manage their costs and performance, what do people need to learn and how do they need see differently to be able to use applications and systems of greater maturity? A vocabulary of human and organizational developmental disciplines helps address these questions. It is used to specifically guide and direct people as they work to better understand and manage their own cost and performance behaviors. Importantly, this initial chapter provides developmental concepts and terminology used throughout this book.

Because cost *accounting* provides the basic vocabulary for cost *management,* the next few chapters discuss cost accounting foundations in some detail. However, the discussion moves gingerly into developing skills in managing valuable resources, including human beings, their attendant costs, and their potential to create value through better performance.

A DEVELOPMENT PERSPECTIVE

Like so many important words—*strategy, tactics, vision, system, ethics, love, in-law*—the word *change* means different things to different people. Consider the array of definitions for the following three commonly interchangeable nouns: change, growth, and development.[1]

1. *Change*
   - The act, process, or result of altering or modifying
   - The replacing of one thing for another; substitution
   - A transformation or transition from one state, condition, or phase to another
2. *Growth*
   - The process of growing to full development; maturity
   - Development from a lower or simpler to a higher or more complex form; evolution
   - An increase, as in size, number, value, or strength; extension or expansion
3. *Development*
   - The act of improving by expanding or enlarging or refining
   - A process in which something passes by degrees to a more advanced or mature stage
   - The process of an individual organism growing organically; a purely biological unfolding of events involved in an organism changing gradually from a simple to a more complex level

Of these three—change, growth, development—only development consistently implies the creation of value within a learning process as an integral component of its meaning. Virtually all senior executives routinely confront heavily marketed change management services and methods to manage growth, as if these activities guaranteed organizational cost and performance development. A brief examination of the obtuse challenges embraced by some of the more common change and growth management methods demonstrates two things. First, they lend themselves to a mechanical, component-based language. Second, they need a disciplined characterization for managing human development as a means to create sustainable organizational value over time.

Origins of Growth and Change Concepts

Examining the origins of the services and methods dedicated to change and growth management, some common but imprecise practices emerge:

- *Change.* Formal change management initiatives usually imply one of two practical scenarios. In the first scenario, the organization's management has experienced the pain of *not* practicing good transformation management principles, and has consequently generated unhappy employees, failed projects, unmet objectives, or other undesirable outcomes. Humbler and wiser, executives now seek to avoid past mistakes. In the second and unfortunately more common scenario, a disconnected executive group blames employees for poor organizational performance and uses formal initiatives in an attempt to force change, and thereby, improve performance.
- *Growth.* Although it is frequently displayed in terms of sales or revenue, growth actually means positive economic profit. Capital markets and owner/investor expectations drive executives to seek pathways to continuous profit growth through better cost and performance management.

Not surprisingly, major initiatives generally fall under the categories of change or growth management. For example, implementation of a new IT system focuses on catching up to market growth that has already occurred, preparing an information structure to handle expected growth, or changing existing applications for improved ease, speed, and capacity. Organizations commonly use performance measurement projects to change the information used to manage the company in the interest of enabling steady growth. Think of any major project, and it will be about either catching up or growing up, and it will always be about change. Change and growth are also the central tenets of human development. Logically, human and economic change and growth cannot be separated.

Managing Change—Naturally

Since the entire physical world and everything in it is subject to constant change, categorical *change management* stands as one of the most absurd management

notions ever concocted. Change in the physical universe generally takes two patterns: (1) *entropy*—the gradual loss of order and increase of randomness in any closed system as occurs in the life cycle of a solar system; and (2) *autopoiesis*—a network of processes of production (transformation and destruction), which (a) maintain their defining organization throughout a history of environmental perturbation and structural change and (b) regenerate their own components in the course of their operation.[2]

Physicists and biologists developed the terms *entropy* and *autopoiesis* to describe the forms of change they observe in the systems they study. Entropy works quite well for physicists and mechanical systems. Entropic systems characterize change as it occurs in mechanical systems and, interestingly, in most organizational change management efforts. The mechanical representations used to characterize organizational change management efforts are all too familiar: linear organization charts to describe the new design, Gantt charts for project milestones, and strategic objectives with their cascading business plans. The organization is managed and understood in terms of its conceptual components. As components of physical entropic systems, solar systems and all the objects and machines they contain eventually and predictably break or dissolve, lose energy, and run down.

Autopoietic systems characterize change as it occurs in living systems, a paradigm discussed but rarely applied in current business management. Autopoietic systems use enduring but adaptable templates to guide production processes. Genetic material allows species to reproduce, produce, and adapt to slowly occurring environmental changes, one individual at a time. The template leads the process of energy utilization. Autopoietic systems change and consume energy continuously, but they enhance themselves and their constituents as they do so. The individual is the essential component of the successful autopoietic system.

From this foundation, two concerns naturally arise in a cost and performance change management context. Each relates to the most limited of all organizational resources: management attention. First, since entropy and autopoietic patterns govern the behavior of everything in the physical world, people navigating cost and performance management change exclusively from the component-based entropic perspective prioritize their attention and activities by fixing the most broken thing first. In terms of management morale, the fire-fighting world of day-to-day organizational management engages an unwinnable battle and leaves little time for organizational development and subsequent value creation.

Second, randomly introduced change initiatives will only run the system into the ground more quickly. While people spend their energy resources trying to keep up with wear, tear, and resource consumption, the organization uses growth mandates and the profit imperative to hold them accountable. Growth and profit directives continually demand the creation of more, more, more. Unlike autopoietic systems that provide templates for the processes of production, the exclusively entropic cost and performance change management systems attempt to create value (profit) by spending resource energy on value-creation efforts that are

ad hoc, emergency in nature, and insufficiently directed. Sustainable value can only be created in the autopoietic system by people who are encouraged and who understand how to do so.

Strategy can serve as the template that leads the cost and performance processes of the organization engaged in change management, but only when all employees understand strategic application personally. People in strategically sterile organizations spend their time fixing the broken because they do not know how to create value despite profit imperative mandates.

Think about human effort (i.e., energy) applied in ever-increasing amounts to the type of customer—and we all know them—who can never be satisfied. The more the supplier gives, the more the customer expects. Frequently, this type of customer is inept at cost and performance management, and tries to make up for these poor practices by increasing demands on suppliers. Moreover, while some inanimate objects and hierarchical environments readily receive enforced change, humans must become ready to accept change. Other than survival scenarios or military environments of voluntary enlistment into a culture of chain of command, forcible change efforts, even in the name of strategy, are recipes for disaster.

Currently, most organizations focus on the material, tangible components of transitions and transformations: Are the accounting systems merged? Have we terminated redundant or nonproductive employees? Is the information technology (IT) application up and running? Do we have all the measures and data for our scorecard? These are all examples of important physical/mechanical system changes. In contrast, few companies have focused attention on intangible, energy-related components such as learning required by individuals and groups, impacts on communities, or development of organizational leaders. These omissions are some of the causes of change effort failures.

A developmentally healthy organization does not gird itself for change as a test of endurance. Instead, a developing organization sees change as a persistent, underlying management condition, and carries out its activities accordingly. Importantly, these activities take place in several simultaneous dimensions including:

- Individual and group
- Organization and community
- Complexity and scope of change
- Degree of urgency and time available for change

Whether or not developmental disciplines are practiced, these factors are all operative every day in every organization.

Managing Growth

Applying the same scrutiny to growth management as a means of negotiating organizational change, more focused and less mechanical options emerge.

Everything changes, but not everything grows. People assigned to promote growth focus on specific sectors, market share, retail outlets, and on specific clients and consumers—women, teenagers, athletes, for example. As a more specific form of change, growth management provides people with more direction on what is to be done, as well as with a higher level of discipline in how to do it. For instance, if a cigar manufacturer wants to expand its sales to high-income women, the market sector is clear, and the advertising and marketing functions will play a key role in creating the new sector context.

What about profit growth? People assigned this responsibility must identify very specific avenues of value creation and direct their resources and energies accordingly. Generally speaking, growth managers must also manage assets with an eye to realizing long-term, sustained performance and positive resource investment outcomes. The gardening metaphor applies to the efforts of people with growth management responsibilities. Gardeners use tools with natural systems to maintain sustainable components that simultaneously generate goods useful for current consumption while contributing to the health of future growth.

While growth management represents a more focused way to negotiate change management, its scope is too narrow to encompass the complexity of today's organizations, and it also falls prey to a mechanical, component-based management vocabulary. Two of the most common growth management contexts—investment portfolios and urban planning—illustrate the essentially conservative nature of the growth management perspective. In each case, asset managers acknowledge certain limits in terms of realizing long-term, sustained performance and resources (e.g., return rates in the market, infrastructure capacity in a city). A similar constraint exists for people in today's business climate. As usually interpreted in most organizations, the profit imperative stands as an urgent and primary mandate challenging the degree to which executives and managers can sustain the mandates of growth management over the long term.

Strategic Change Management

The twentieth century witnessed a strong trend for more and more organizations to employ formal strategic plans to direct change and growth activities. At last count, scholars and organizations belong to one (at least) of ten different schools of strategy.[3] Strategy is not the only framework to organize activities, but it currently dominates the organizational landscape. Acting much like the information stored in the human genome, strategy can articulate what an organization will become and how it intends to enhance and perpetuate its successes.

Most approaches to strategy boil down to different ways of seeing the organization as an active agency in a defined environment, but all share one common characteristic: Each endeavors to make an educated guess about the best means to achieve a specific end, and all frameworks involve four basic steps:

1. Explore and compare opportunities.
2. Choose opportunities.
3. Prepare and mobilize resources.
4. Implement.

Since strategy is a game of well-intentioned guessing, strategic change managers have at least two chances (but probably more) to make significant errors before implementation of change management initiatives.

1. Choose the wrong goal.
2. Prepare incorrectly.

Autopsy reports commonly list these two errors as the chief post-mortem findings for strategic unhappiness. Some subtle causes lurk behind these errors.

First, when strategic change management works within an overly compartmentalized organization that relies heavily on hierarchy and chain of command to maintain control, strategy becomes another mechanical exercise that focuses more on managing the conceptual components of the organization than on directing and aligning the activities of its people. Consequently, even with a sound strategic plan, the success rate for achieving strategic change management objectives is notably low.

Second, when strategic planning becomes mechanical, management fails to recognize what Eli Goldratt calls the organizational "prime measure"—the mother of all measures that tacitly drives all decision making and foils change efforts that challenge it. In socialist economies, the prime measure was number of units produced, regardless of type, demand, or quality. In a public university setting, the prime measure is often budget dollars acquired and spent. In the majority of American firms, the prime measure is one more related to profit and any product, service, or activity such as return on investment (ROI) or earnings per share (EPS). Although the prime measures seem logical, they reflect the organization's unique brand of comfortable, cultural myopia, practiced and unchallenged for so long that it becomes invisible. Still, it remains the foundation of most management choices. Consequently, organizations rarely examine the prime measure's relationship to the profit imperative and the impact it exerts on decision making and resistance to change.

While strategically aligned change management practices provide long-term perspectives for organizational cost and performance decision making, the profit imperative continues to be the prime strategic mover in most organizations. Strategy loses its power when executives and managers confuse profit goals and strategy by basing their decisions on profit implications and mandates alone. Profit is not a strategy; profit is a result of a strategy successfully implemented.

Third, strategic change management efforts naturally fail when people don't understand their own purpose within the strategic context. Subtle? So it would

seem. Strategy must be interpreted uniquely so that each employee understands general organizational strategic intentions within a personal context. How many change initiatives attempt to do this? Daily choices made at every level of the strategic organization are based on how much the person making decisions can see choices within a strategic context. Leave the organization's people out of the strategic process as a surefire guarantee of strategic failure.

No Lack of Methods and Tactics

There is no lack of methods and tactics for working toward change, growth, and strategic goals; there is no guarantee that they will work. Many executives and managers have come to believe that change management efforts fail because either the tools or the people who use them are defective. This view clearly falls within the mechanical, direct cause-effect perspective. Something is broken. When an activity-based costing or a Balanced Scorecard implementation fails (yes, some actually do),[4] what was the cause of failure: Strategy? Method? People?

From its inception as a military concept, strategic realization has always depended on tools for implementation, commonly called *tactics.* A wide variety of business tactics and methods are now available. Some of the most well-known include total quality, reengineering, Theory of Constraints, activity-based costing, resource consumption accounting, the Balanced Scorecard, Economic Value Added, target costing, supply chain management, and enterprise resource planning. These are examples of the common, popular management tools for sale in the change management marketplace.

As a mechanical metaphor, tools are instruments of work designed to make things better and fix what is broken. Organizations that adopt new management methods and tactics expect these tools to fix problems, and they spend large amounts of money to meet those expectations. However, most management tactics and methods are complex and specialized solutions that only work in the proper context when expertly applied. Too often, organizations purchase and begin to use these tools with all the forethought of a parent putting a chainsaw in the hands of a 13-year-old. Management methods only function when implemented in the correct context and administered by people of appropriate maturity. As tools to effect change management intentions, organizations select tactics and methods mechanically or arbitrarily and place them in the hands of unqualified, unprepared employees. The result: both the tools and the people seem broken.

Historical context sheds some light on the roots of all these tendencies to treat the organization as a machine rather than a collection of people who hold a stake in its success. Management science is rapidly emerging from the black-and-white simplicity of Frederick Taylor's mechanical Scientific Movement, the paradigm that fueled the industrial age. As executives and managers search for ways to understand the black box of the new management challenge, the Human Factor, they discover that sound change management strategies, methods, and tactics cannot be implemented without engaged people. People cannot and will

not voluntarily engage a strategy, method, or tactic unless they see the point—unless they become interested.

Making Change Interesting

Three conditions characterize people's ability to see the point of changing a cost or performance management strategy or method:

1. Threat to survival
2. Incentive
3. Readiness

Threats are unpleasant and incentives are expensive. As an alternative, executives and managers need a well-tested method that invites, or even creates, a noncoerced readiness to embrace change. Fortunately, managers in the last two decades of the twentieth century gained some important insights into a different context for managing human factor variables—organizational culture. Consider the root definitions of *culture*:

- A particular civilization at a particular stage
- The tastes in art and manners that are favored by a social group
- All the knowledge and values shared by a society[5]

A civilization, a social group, a society—why not a business? The best research in the human resources discipline seems to confirm that each organization has its own unique culture of values, knowledge, tastes, manners, and developmental readiness for something new. In fact, the Consortium for Advanced Manufacturing–International (CAM-I) has begun to build readiness diagnostics into activity-based costing implementation methodologies. These readiness instruments assist CAM-I members in laying groundwork for successful initiatives. Many experienced and developmentally mature activity-based costing/management (ABC/M) practitioners dropped their egos for the good of the whole and laid out explicit reasons for ABC project failures. From that list, CAM-I developed the readiness assessment. The intention is to stem the tide of ABC/M project failures.

Beyond the relatively simple parameters for organizational participation such as personal preferences or willingness, readiness in a developmental context means the capacity to engage and use a new way of seeing. Personal preferences and willingness change from day to day based on many individual factors. In contrast, the capacity to see in new ways is a permanent acquisition. Management methods and tactics have the potential to give employees at all levels a new way of seeing the organization, its assets, its activities, and even its purpose.

Children need to learn basic arithmetic and algebra before they can learn calculus. The best educators rely on proven human developmental patterns and

defined readiness capacities in K–12 curricula. Likewise, developmental sciences provide a map for assessing and creating organizational readiness so that people can embrace and support cost and performance management change initiatives. It is just as futile to give a tome on an advanced business method to an inexperienced employee, as it is to give an average eight-year-old a calculus book. In other words, none of the business tactics listed earlier can be successfully implemented by following a blueprint of milestone steps that map the way to completion. The real implementation work lies *between* the milestones where learning and practice take place, and where readiness develops naturally.

As executives and managers pick and choose from the variety of available change management tools, organizational developmental principles can help them choose methods and prepare their employees more precisely. The chapters that follow characterize the most common cost and performance management methodologies in terms of what they can offer organizations, leadership, and employees at different levels of developmental readiness and maturity. To facilitate this presentation, the remaining sections of this chapter introduce the essentials of organizational development and learning.

DEVELOPMENT AS CATALYST FOR RELIABLE, RAPID CHANGE

In chemistry, catalysts provide a more efficient path for molecules to interact and transform themselves into a new product. In this discussion, a catalyst efficiently and predictably brings two or more discrete participants into productive relationship. In essence, catalysis is a transformative event for all participants in the relationship. The catalyst allows change to occur more easily, more quickly, and more efficiently, and more reliably than if the catalyst was not present. The disciplines of human development work like a catalyst for people and groups of people within an organization as they work to negotiate and produce meaningful change.

Because individual and group activities take place in a physical world based on the energies of many discrete participants, the scientific principles of catalysis translate directly into organizational life. Importantly, without a catalyst, participants enter successfully into productive relationship only by random chance.

Imagine molecules (or people) in a glass beaker (or company headquarters) moving randomly by each other with an occasional productive interaction. Just as the molecule follows the random path created by its own momentum and the influence of recent collisions, each person moves about according to a sense of professional roles and responsibilities as guided by personal experience and organizational mandates from the budget, strategy, incentives, or other control mechanisms.

Catalysts work by decreasing the activation energy of an event—the amount of energy normally required for an event to take place when participants interact randomly. Activation energy is the amount of energy expended by all participants over time for a reaction to occur. Most of the reactions that occur in living cells

would occur too slowly (if at all) to support life without natural, biological catalysts called enzymes. Some enzymes increase reaction rates in human cellular processes by a factor of more than one billion. As catalysts, enzymes are highly specific. Catalysts provide a unique structural surface that brings the key components of an event into optimal position for a rapid, stable, predictable, controlled reaction.

Like molecules, people participating in a productive change relationship must come into a precise alignment with one another for the relationship to bear fruit. Molecules have it easy. They require only a precise physical relationship with one another. When it comes to new change management practices, different people within the organization must learn to see how their personal work roles and responsibilities align with entirely different roles and responsibilities. This alignment is the arena of developmental disciplines as catalyst for organizational learning during strategic and tactical management changes. This section reviews the essential principles of human and organizational development in terms of cost and performance change management applications.

DEVELOPMENTAL ESSENTIALS

A specific definition of human development applies, whether the context is individual or organizational: *Integrating the capacity to see relationships between the self and the environment in new ways.* Within this definition, *integrating* means that the new capacity becomes a permanent ability or competence; *capacity* implies a new faculty for potential growth, development, or accomplishment; *see* literally means that perspectives on relationship broaden; and *new* has several shades of explicit meaning. A new capacity to see means seeing something never seen before, not just more of what has always been there. A new capacity to see adds more comprehensive perspectives that do not negate the previous simpler perspectives but instead add meaning to and complement them. For example, companies that use performance management often claim that using a set of strategic financial and nonfinancial measures increases the effectiveness of communication of strategic priorities throughout the firm. Similarly, an ABC framework gives people new ways to see the organization's cost and resource utilization behaviors.

Several schools of human psychology have each created a specific perspective on human development and behavior, and as a subsystem of the overall process of development, each school characterizes its own set of steps that normal people move through as they achieve greater levels of maturity. Some of the more meticulously characterized subsystems of human development include cognitive, moral, social, needs, and self-identity shown in Exhibit 1.1.

Despite this wide range of focus, the subsystems of human development demonstrate five essential consistencies that apply to the capacity of organizations to learn and implement new management methodologies.

Exhibit 1.1. Subsystems of Human Development

Cognitive[6]	Moral[7]	Needs[8]	Self-Identity[9]	Psychosocial[10]
sensorimotor	punishment & obedience	survival	symbiotic	trust vs mistrust
preoperational	instrumental hedonism	safety	self-protection	autonomy vs shame and doubt
concrete operational	law & order	membership	conformity	industry vs inferiority
formal	universalism	self-esteem	conscientious	identity vs role confusion

1. All developmental processes follow a *fixed sequence of stages*, and all individuals master the stages of maturity in the same order.
2. While some may learn more quickly, *no one skips any stage*, and the lessons learned in all earlier stages are retained. Early stages contain lessons that are necessary for mastery of the stages that follow.
3. Consequently, developmental learning is truly an integrative process. Developing beings experience lasting change as they move to more mature stages. Unlike the lessons of an MBA statistics course, *developmental lessons become a permanent part* of one's outlook.
4. In the normal process of developmental integration, *subsystems co-evolve.* Individuals are as *mature as their least* mature subsystem (see Chapter 9). The idiot-savant who calculates π to 150,000 digits but cannot tie his own shoe is less mature than the five-year-old girl who knows $2 + 2 = 4$ and dresses herself.
5. The self-assessment of one's current stage of maturity is inversely proportional to actual progress. The less an organization has learned, the more advanced it believes itself to be. Ask any parent.

Cognition and Organizational Development

A *cognitive* subsystem is the best single representative of these developmental essentials as they relate to organizations for several reasons. If we truly find ourselves in the Information Age, then we depend on our cognitive abilities to make data and information meaningful. Practically speaking, beyond technical terms, most executives and managers today find themselves overwhelmed by moral, social, emotional, and identity vocabularies in the business literature, so to use